THE HINDU

OPINION » **LEAD**

Published: May 8, 2015 01:52 IST | Updated: May 8, 2015 02:04 IST May 8, 2015

Getting federal transfers right

PINAKI CHAKRABORTY

Pinaki Chakraborty

With the flow of untied resources increasing to States, the focus must now be on non-Finance Commission transfers to enable States to effectively utilise the enhanced fiscal space. This is done by changing the coverage and architecture of the non-Finance Commission transfers

The Fourteenth Finance Commission's recommendation to increase tax devolution to 42 per cent of the shareable pool of taxes has increased the flow of untied resources (or resources transferred without condition) to States. Estimates show that post the 14th commission award, the untied statutory transfers would be more than 70 per cent of the aggregate resource transfers from the Union to the States. Although this increase in the share of untied funds is a marked improvement in the structure of a transfer away from a conditional to an unconditional one, it is time that attention is paid to reform the transfer system by focussing on non-Finance Commission transfer to enable States to effectively utilise the enhanced untied fiscal space. This can only be done by reforming the coverage, content and architecture of the non-Finance Commission transfers and a further consolidation of schemes. This article discusses this important issue and provides a possible way forward keeping in view the recommendations made by the 14th commission in this regard.

Budget and non-FC transfers

A major issue, post Budget 2015-16, is the sharp decline in allocations to the social sector in the form of various conditional grants to the States. This decline has happened to accommodate a large increase in tax devolution. As per the Budget estimates, enhanced tax devolution should result in an increase in the flow of untied funds to the tune of Rs.1,86,150 crore and a reduced flow of grants to the tune of Rs.87,730 crore.

This decline in grants has happened in two categories: in a specified list of schemes where the Centre's contribution has been reduced, implying a corresponding increase in contribution by the States and for a set of schemes where Central support has been withdrawn. Important schemes in the first category are the Rashtriya Krishi Vikas Yojana, the Integrated Child Development Services (ICDS), Swacch Bharat Abhiyaan and allocation for elementary education under the midday meal schemes and the Sarva Shiksha Abhiyan (SSA) financed by the Gross Budgetary Support (GBS). Major schemes delinked from Central support are the Jawaharlal Nehru National Urban Renewal Mission, the Backward Regions Grant Fund and Normal Central Assistance. The Union Budget does not provide the details of the additional contributions States have to make for schemes where Central support has been reduced. This change in the structure of grants has also to be viewed in the context of a restructuring of Centrally sponsored schemes (CSS). Despite this emphasis on restructuring and recommendations made by various committees in this regard, nothing much has happened on the ground. In fact, CSS and other conditional grants as a percentage of GDP have increased from 0.67 per cent in 2000-01 to 1.39 per cent in 2015-16. Post the 14th Commission's recommendation, the reduction in grants to accommodate a large increase in tax devolution — of which many are CSS — is certainly a step in the right direction. However, this reduction in grants in quantum without clarity on the design, architecture and sharing pattern between the Union and States has the following implications for States: a) reducing the share of contribution of the Centre to CSS has the potential to reduce untied fiscal space available from higher tax devolution as States have to make a higher contribution to these schemes now; b) this reduction does not automatically imply that States are insulated from the conditionalities and 'one size fits all' CSS intervention and the uncertainties associated with CSS fund flow.

Why restructuring is critical

In the last decade, the proliferation of big-ticket CSS has emerged as the key fiscal strategy to transfer grants to States to achieve a certain outcome in a specific sector, especially in health, education, agriculture and rural development. Though the money allocated under CSS has declined, these schemes, if not reduced in numbers, and, in many cases, consolidated and restructured, may result in States having to fund these schemes with a higher matching contribution. And, they may have to bear the same burden of CSS conditionalities, reducing fiscal autonomy and the available untied fiscal space.

Restructuring is not only important from the perspective of State finances. It is also about getting the expenditure priorities right for both the

Union and the State governments. As articulated in the 14th commission's report, "between 2002-05 and 2005-11, revenue expenditure by the Union Government on State List subjects increased from an average of 14 per cent to 20 per cent, and on Concurrent List subjects from an average of 13 per cent to 17 per cent. This implies a reduction in expenditure, in percentage terms, on Union List subjects. Expenditure functions under the Union List fall predominantly under General and Economic Services. The share of expenditure on these has progressively declined from 66.3 per cent in 2001-02 to 53.2 per cent in 2014-15(BE)." One of the primary reasons for this is the proliferation of CSS, especially in the social sector and on right-based spending. For better service delivery outcome, these need to change as most of these functions are primarily in the functional domain of the States. The Union government should move its focus from spending on overlapping functional domain to subjects that squarely fall in the functional domain of the Union, as in the Union List, and limit its intervention on the 'State List' and 'Concurrent List' on subjects of national priority having a consideration of externality.

Kind of restructuring

There are 34 schemes listed in the category where Central support is fully provided for in the Budget. Full Central support is not 100 per cent Central funding. In these schemes, States have to make a matching contribution as per the existing fund sharing arrangement. The distribution of resources allocation across these schemes shows that out of 34 schemes, the aggregate share of 15 schemes works out to be 1.72 per cent of the total grants, with a total allocation of Rs.2,039 crore and an individual share of less than 0.5 per cent of the total grants. Schemes with an allocation of less than one per cent are five and their aggregate share in total grant works out to be 4.09 per cent, with a total allocation of Rs.4,849 crore. There are 10 schemes with an allocation of less than 10 per cent and their aggregate share in total works out to 24 per cent of the total allocation, where the total allocation is Rs.28,000 crore. In other words, 70 per cent of the total allocation is for four schemes, namely, the National Social Assistance Programme, externally aided projects, schemes financed from the Prarambhik Shiksha Kosh and the Mahatma Gandhi National Rural Employment Guarantee Scheme with a total allocation of Rs.82,775 crore. The number of schemes with a changing sharing pattern is 20. But in many of these schemes, the number of programmes under each category as an umbrella programme if considered, would total 56. In this case also, seven schemes account for 85 per cent of the total allocation. The major schemes in this category are the National Health Mission, the ICDS, and schemes for agriculture and sanitation. Since resources are thinly distributed with a tiny allocation across many schemes, it is time these schemes are consolidated and made into a few national schemes in key sectors; minor schemes can be devolved down to the States with funds.

Principles of restructuring

Also, with a significantly higher tax devolution to the States, much of the expenditure priorities would have to align in a manner as envisaged in the Constitution. Sectors where significant State spending rather than a "one-size fits all" Union government scheme would be more appropriate are health, education, agriculture and rural development. Now, the larger question crops up. When States are the major spending entities in these sectors, as these functions fall primarily in the functional domain of States, should they not be given the fiscal autonomy to carry out their own programme to address differential needs? In this context, should one be too worried about the decline in spending in the Union Budget for some of these sectors? Instead, the focus should be to reform the non-finance commission transfers to make the transfer system transparent, efficient and fiscally non-intrusive unless required. It is also time we take a comprehensive view of spending by taking the Union and State interventions in sectors where States are the primary provider of services rather than focussing on what is allocated by the Union Government.

Finally, this is not to argue that Central intervention does not have a role to play in development spending. Rather, such interventions should be limited to a few national priorities. As articulated in the 14th Commission report, the Union government is currently transferring around 63 per cent of the shareable pool of taxes to States in the various forms of transfers. The commission's recommendations have left a fiscal space to the tune of around 15 per cent of the shareable pool for the Union government's intervention on subjects of a national priority in the social and economic services. This fiscal space, as argued in the report, should be used in the framework of "cooperative federalism" with the active involvement of States on the design, architecture and implementation framework of such schemes to avoid the proliferation of a 'one size fits all' CSS, as was the practice in the past.

(Pinaki Chakraborty is Professor, National Institute of Public Finance and Policy, New Delhi. He was Economic Adviser to the Fourteenth Finance Commission. The views expressed are personal. E-mail: pinaki.chakraborty@nipfp.org.in)

Printable version | May 11, 2015 3:43:33 PM | http://www.thehindu.com/opinion/lead/getting-federal-transfers-right/article7181478.ece

© The Hindu